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Tipping the Balance: Russian Legal Culture and Cash-Settled Derivatives

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Introduction

January 26, 2007. A day as any other in Moscow, a busy city striving for wealth and success, except that it was a day that drew the line in a legal battle over cash-settled derivatives: they became enforceable under Russian law. The battle had lasted for almost a decade and was triggered by events of 1998 when the Russian government defaulted on its short-term bonds and devalued the Russian currency. Trying to save the country's banking system from collapse, the Bank of Russia announced a three-month moratorium on foreign debt payments - cash-settled forward obligations.¹ A number of big global banks, such as Goldman Sachs, Merrill Lynch, Nomura, and JP Morgan, exited the market bearing heavy losses with the intention to file lawsuits against banks in Russia. Meanwhile, suffering losses from defaults on the same contracts traded with each other, Russian banks also initiated legal disputes. The ultimate result of the legal actions was a court statement maintaining that the contracts were bets, thus not legally enforceable under Russian law because 'in the dealings the

¹ A cash-settled forward contract is an obligation to buy or sell a certain currency at a fixed price (exchange rate) on a determined date in the future, but when the time to execute the contract come, instead of delivering the currency parties settle the difference between current and the contacted exchange rate. The contract will be explained in more detail later in this article.

parties accepted the [...] risks and there was no evidence that the deals were of economic necessity' (FAC 1999).

The issue of gambling is a recurrent problem for financial derivatives - across the world legal systems have been hostile to this type of deals. In its analysis that draws on the significance of yet another instance of problematic legitimization of financial derivatives this paper contributes to a substantial body of work that shows how financial world struggled with the adverse attitude toward it - through, for example, the attempts to legitimise financial derivatives by bolstering the contracts with the authority of economics (MacKenzie & Millo 2003), or the development of the notion of financial risk (Goede 2005), or the 'transformation of investment into a science' and the emergence of 'true speculation' (Preda 2006).²

It would seem that the battle was finally over in 2007, when financial derivatives were finally recognised as legitimate under Russian law. But two things are in retrospect striking in this case study. First, given the financial markets' surge and the necessity of global integration of Russian economy it would seem unreasonable to treat financial derivatives as bets in Russian law for nearly a decade, between 1998 and 2007. Second, although the change that global financial markets had made a few decades earlier was implemented eventually and the distinction between gambling and financial derivatives was made in Russian law, it took a very peculiar form as it classified the derivatives as gambling deals but enforceable in Russian courts. In

² For more accounts on the legitimisation of gambling see also Swan (2000), O'Malley (2003).

consequence, this article's focus is on how the legal framework for financial cash-settlement was produced and why it materialised in such an unconventional way.

Focusing empirically on an apparent legal technicality - the development of the Amendment to Article 1062 of the Russian Civil Code - this paper demonstrates the consequentiality of the local legal culture to the outcome concerning an important class of financial products: cash-settled currency derivatives traded over-the-counter, by direct dealings between banks. In so doing the article contributes to a body of research - social studies of finance (SSF) - which pays much attention to the materiality (as 'physicality, corporeality, technicality' (MacKenzie 2009, p.2)) of financial markets.³ For example, the researchers demonstrate the materiality of apparently virtual financial markets by revealing the crucial importance of expert knowledge in the markets, be it economics understood in a broad sense, as an assemblage of participants and practices of all kinds, including technical systems (Callon 1998, 2005; MacKenzie et al. 2007; Muniesa et al. 2007; Pinch & Swedberg 2008), or economics 'in the academic sense', such as financial theory (MacKenzie 2006). In its emphasis on a legal amendment an aspect of materiality this article is concerned with is the legal technicalities of financial markets. So far little attention has been paid to legal expert knowledge that produces and shapes the markets; the rare exception is the scholars who examine the legal implementation of netting in Japan (Riles 2011), and deceptive behaviour in financial markets (Lépinay & Hertz 2005). However, there is a substantial lack of detailed investigations of how, for instance, a particular law enables certain financial trade, thus facilitates the material production of a markets. Yet, legal technicalities are able

³ On the SSF-materiality link and genesis of social studies of finance see MacKenzie (2009).

to reveal how financial markets are essentially social (or ‘collective’ (Latour 2005) for that matter), thus instantiate the social studies of finance approach at its best, given the SSF’s ambition to unify ‘the “social” and “technical” [as they] are inextricably linked in market construction’ (MacKenzie 2009, p.181).

The followed examination draws upon data obtained by conducting 35 semi-structured interviews with legal experts in financial regulatory authorities, financial lawyers in banks and in legal firms, brokers and bank traders based in London and Moscow.⁴ The research is also based on an analysis of statutes (laws and regulations), typescripts of parliamentary debates, and the monitoring of financial media coverage.

The paper starts with a discussion of the concept of legal culture, it then turns to the details of a cash-settled currency forward, its role in Russian financial crisis of 1998 and litigations regarding its gambling status in Russian law. The article continues with outlining why and how disputes regarding Russian legal framework for cash-settlement were instigated, and the outcome of the controversy. The discussion and

⁴ The confidentiality of the information was not a straightforward matter. All but one of the interviewees yielded a ready consent to their names being revealed. However, in the process of transcribing the interviews it became clear that often the informants had been very candid about fairly sensitive issues, such as, for instance, the politics of decision-making processes in the Federal Assembly of the Russian Federation. After careful consideration, in order to do no harm to the informants, it has been decided to keep all the interviewees anonymous. For more detail on the interviews, see Appendix.

conclusions return to the main argument about the importance of local legal cultures as actors in their own right, rather than a backdrop for the all-decisive power struggle.

Local Legal Cultures

The consequentiality of law and regulation in financial markets has always been a domain of ‘law and economics’ - economic analysis of how effective legal rules are (see, for example, Llewellyn 1999; Spencer 2000; Padoa-Schioppa 2004). As Halliday and Carruthers (2009, p.15) put it, ‘sociolegal scholarship itself has effectively abandoned inquiry into the origins of law-on-the books [...]. Instead, this task was appropriated by political science’. Furthermore, given the long-standing tradition of legal realism, it seems commonly recognised that politics - as a set of negotiations and agreements over what is sensible under the circumstances – is what law is about; existing attempts to analyse the making of law and regulation that format economic and financial activity all emphasise that law-making is primarily a political process. For instance, a notion of political interest becomes central in studying the manufacturing of rules and laws by regarding ‘policy-makers as self-interested agents responding to political incentives’ (Pagano & Volpin 2001, p.503; Stratmann 2002; Rajan & Zingales 2003; Mooslechner et al. 2006). The same interest-based approach also prevails in sociological enquiries, where it is argued that law manifests the most influential groups’ interests, viewing financial law-making as either a conflict of ‘politically connected elites’ (Fligstein 2002, p.210) or ‘struggles *among* professions’ over their regulatory domains (Carruthers & Halliday 1998, p.54, emphasis in original). Be it a conflict of interests or a search for common ground, researchers are united in their understanding of economic or financial law-making as a process where politics indeed ‘appears at the turning point, in the place where the

efficiency of economics is negotiated and where the need to forward it, reshape it, and complement it emerges' (Cochoy et al. 2010, p.145).

Undoubtedly, politics plays a pivotal role in financial law-making and, as this article will later demonstrate, the discussions around legal framework for cash-settled derivatives were indeed political (in a broad sense) and being shaped by politics (for instance by a conflict of the financial regulators). However, this paper seeks to emphasise the importance of yet another aspect – local legal culture - by articulating this concept in distinction to politics. Having placed great emphasis on politics, in fact having identified or 'confused' law with politics as Latour (2009) argues, this approach to law-making has resulted in the widespread belief that the observed clashes of interests, pursuits of dominance and control, or encouragement of collaboration have been taking place in a realm with no constraining or enabling presence of local legal cultures. Latour (1987, p.201) defines culture rather unconventionally, he sees it as 'the set of elements that appear to be tied together'. Given the contested nature of the term 'culture' (Latour 1987, 2005; but see also MacKenzie 2011 for more general discussion of its usage in SSF), Latour's (1987, p.201) understanding of it is indeed helpful, because to be able to claim that local legal culture is an actor in its own right rather than a placeholder for negotiations, it must be shown as distinct from politics, whereas its appearance is most evident (therefore obtains 'a precise meaning' of what it is) when the very existence of it is challenged. Moreover, actor-network theory (ANT) lends yet another important insight that, if coupled with the crucial importance of controversies for revealing what culture is, allows to avoid the mistake of using terms 'law' and 'politics' interchangeably. According to ANT, the elements (actors) that are tied

together in a chain of associations are both human and non-human, and the latter (in a form of scientific tools, for instance) must not be ignored in tracing networks that produce robust facts, undisputable elements of knowledge, ‘black boxes’ (Latour 1987, 2005).

By suggesting ‘to focus on the agency of the technicalities’ as ‘mundane tools’ in legal practice Riles (2005, p.989) insightfully employs the ANT argument in the study of law. One has to ‘think about legal knowledge more broadly’, she argues and suggests the new agenda ‘for the cultural study of law’: ‘taking on the technicalities’ (Riles 2005). For example, in her ethnography of ‘legal knowledge’ in the Japanese derivatives market Riles (2011) demonstrates the importance of ‘legal techniques’ or ‘lived practices’. They matter because the technical is a ‘the protagonist of its own account’ rather than ‘an effect or a byproduct, a tool of more important agents and forces’ (Riles 2005, pp.985,988).⁵ The main way in which this paper concerns the technicalities is by focussing on a legal text (as an embodiment of legal techniques) as a non-human actor in a chain of elements which, when disputed, reveal themselves under the term ‘legal culture’. Furthermore, the analytical tradition of science studies incorporates many approaches; for example it shows the role of ‘interpretative tradition’ in re-employing scientific tools (objects and theories), in other words the

⁵ The omission of the term ‘legal culture’ could be attributed to the author’s position: through identifying two communities among legal scholars – the ‘culturalists’ (and those considering law ‘the outcome of political compromise’ are among them,) and ‘instrumentalists’ (who perceive law as an implement used for a particular purpose) – Riles (2005) puts forward a new subject: ‘the technical’.

existence of the ‘local scientific cultures’ (Barnes et al. 1996, p.x; see, e.g. Knorr Cetina 1999 on ‘epistemic cultures’ and social studies of finance works of MacKenzie 2011 and 2011a⁶). In consequence, as invoked here, the term ‘legal culture’ is also analogous to ‘local scientific cultures’. The conceptual approach adopted in the paper suggests that local legal culture is a composite of both distributed agencies and interpretative acts, and in doing so it synthesises the insight of two science studies approaches - actor-network theory (ANT) and finitism - while setting aside their weaknesses.

In his ethnography of knowledge production within a specific branch of civil law, Latour (2009, p.260, emphasis added) defines legal culture as ‘an original form of contextual networking of people, acts and *texts*’. The latter component - the texts – is what differentiates between the ANT approach and finitism in their treatment of culture. By abandoning the object/subject disunity the actor-network theory argues that law-making and legal reasoning stay ‘within the world of texts’ (Latour 2009, p.201); text is what constitutes legal culture, it is part of a distributed agency of law-making. Finitism, on the other hand, suggests keeping objects and subjects apart; what matters is the process of construction of knowledge about ‘unconcerned’ objects (Barnes et al. 1996, p.54), for instance by drawing on conventions and precedents. Classification, as a key process in the knowledge construction, also relies on

⁶ That such ‘cultures’ are typically seen as very local means that the wider controversies (especially in anthropology) concerning the concept of culture, cultural essentialism, orientalism, etc., have been little taken up in SSF (though see MacKenzie 2011).

conventions; it appeals to similarity of things being classified. However, and this is another insight this paper employs, similarity is not ‘sameness’ because ‘to apply a term on the basis of resemblance is to extend an *analogy*’, in itself an unpredictable, ‘open-ended’ act of making a comparison based on correspondence rather than sameness (Barnes et al. 1996, pp.54–55, emphasis in original). As this paper set to demonstrate, such acts of comparison produce a new form that can indeed disconfirm the original it corresponds to.

To refine the argument, the outlined difference in how ‘culture’ is conceived of by ANT and finitism is helpful in emphasising the complexity of the notion of legal culture. Legal texts matter, as ANT points out, and finitism is wrong to deny them agency. But texts never speak unequivocally, as finitism rightly argues. What they speak through is culture. If anything that makes a difference is an actor – as ANT asserts – then legal cultures are actors, they cannot be reduced to politics and need to be taken into account.

Cash-Settled (Non-deliverable) Currency Forwards and the Russian Default of 1998

What is the transaction that was considered as a bet under Russian law? A currency forward is an agreement to buy or sell a currency at a certain price on a certain day in the future. It is a contract traded over-the-counter (OTC), by either direct or brokered negotiation between banks; banks also act as dealers, i.e. they trade currency forwards on behalf of their clients (for example corporations, investment funds, etc.).⁷ Unlike

⁷ A forward contract traded on an exchange is called a ‘futures contract’ and if a price of a forward is the same over the contract duration, a price of a futures contract is

the foreign exchange trade where a currency is bought/sold today, in forward trading banks use today's exchange rate but the currency is delivered to the buyer in the future - for example in one month's time if it is a month contract - so that the exchange rate is fixed for that month. However, in cash-settled (non-deliverable) forwards, instead of getting the currency in one month's time the buyer and seller check the current exchange rate and settle the difference between this rate and the contracted rate. Therefore, before everything else, a both deliverable and non-deliverable forward contract is a tool to secure an exchange rate for a certain period of time. The absence of the delivery of a currency in cash-settled forward is essential in the situation where banks need to lock the price of a currency that cannot be freely circulated due to existing restrictions with regard to the currency's convertibility, as it was the case with the rouble in the 1990s.

In 1997-98 the forward trade between international banks and Russian banks (the so called cross-border market) grew to large volumes⁸. The rapid expansion of the trade was a result of the growth in another market. Amid snowballing budget deficit and tight political situation (Boris Yeltsin was hoping to secure his presidency in 1996 election by proving of being capable to improve the deteriorating economic situation), the Russian government embarked on financing the country's budget by issuing the

marked-to-market, or evaluated daily on an exchange. Also, unlike a forward, a futures contract is standardised, a ready to buy/sell instrument that is not affected by counterparties' guarantee of performance since it is the concern of an exchange's clearinghouse.

⁸ By the autumn of 1998, the outstanding notion value of the deals was variously estimated between \$6.5 and \$365 billion (Ippolito 2002; Thompson 2002)

so-called GKO (short-term government bonds), which were offered to foreign investors as highly lucrative deals - up to 150 percent interest paid in the summer of 1998 (BR 1998). The bonds were rouble-denominated, and, as at that time a head of the Open Market Operations Department in the Bank of Russia explained, ‘nobody invests in to risky assets denominated in a national currency without currency hedging [protecting against exchange rate fluctuations]’ (Korishenko 2008). To fix the price of the rouble global banks were buying non-deliverable forwards from Russian banks. However, following the East-Asian financial crisis of 1997 and the subsequent sagging in oil prices, the Russian current account showed a rapid deficit increase in the first six month of 1998. Viewed as an indicator of an increasing default risk, this triggered massive sales of GKO and repatriation of capital. The surging demand in US dollars set off the escalation of its spot price and depreciation of the rouble - within few months the exchange rate went up from 6.2 to 20.6 roubles to the US dollar (BR 1998a). On August 17, 1998, Russian government defaulted on GKO and devalued the rouble. Russian banks could not execute the forward contracts that demanded 3 times more expensive dollars. To rescue them, the Bank of Russia introduced the 90-day moratorium on commercial debt, thus putting all the forward contracts on hold. Commenting on the default few years later, Konstantin Korishenko (2008), who was viewed as one of the father-founders of the GKO market, admitted that ‘the gain or losses from restructuring of GKO were appallingly less than the gain and losses in the forward market, and that is why all the problems seen as foreign investors’ GKO troubles, were in fact the forwards troubles’.

In the months that followed, it became clear that the sharp rise of the non-deliverable forwards had been happening in a scarce regulatory environment. Furthermore, the

advantage of cash-settlement in currency forwards entailed considerable risk: without delivery of an item (a currency) the transaction could be classified as a bet. In fact, a few months before the default, a court decision had already made cash-settlement unenforceable under Russian law. On February 17, 1998, the Arbitration Court of Moscow City dismissed a claim of US \$141,543 debt by the Investment Bank of the Interpreneurship Support (IBES) to the Interregional Commercial and Industrial Bank (ICIB) under the contract the banks entered into on September 22, 1997. The contract's item was a price of shares (not a currency exchange rate) and according to the terms of the contract a settlement was expected to take place in three months time on December 15, 1997. On the due day IBES did not settle the transaction and ICIB took legal action against the debtor. However, the plaintiff's claim was dismissed on the grounds that it was unenforceable because the contract was 'a bet, since the shares were not delivered by the parties' (FAC 1998). In an attempt to collect the debt ICIB made an appeal urging a closer examination of the contract as it was based on the definition given by the Bank of Russia with regard to currency forwards, but the court disregarded the Bank's regulation and dismissed the appeal.

Seemingly, however, at that time it went unnoticed by those banks trading cash-settled derivatives. Yet, when the plummeting rouble resulted in a cascade of defaults on the contracts, the previous dismissal of the monetary authority's regulation resulted in inconsistency in subsequent court rulings in relation to currency forwards.

Ultimately, however, the Bank's regulation was not considered as sufficient grounds to sustain numerous claims with regard to cash-settled derivatives. Article 1062 of the Russian Civil Code was referred to again, reaffirming the gambling character of cash-settlement in currency forwards.

Not wishing to resign to the court verdicts the banks went on litigating, with the Banque Société Générale Vostok questioning the very constitutionality of Article 1062 (the bank claimed it contradicted the Constitution of Russia that guaranteed the right to entrepreneurial activity). However, the Russian Constitutional Court denied the claim reasoning that the Civil Code did not obstruct the justice because the course of justice is subject to the particular case (CCRF 2002).

As the Russian economy was recovering from the default of 1998, there was a growing realisation of the necessity of changes in the Russian law regarding cash-settled financial derivatives. The final negative ruling of the Russian Constitutional Court was issued with comment on its verdict, where the Court admitted that the application of the gambling law to cash-settled derivatives was indeed an impediment to trading and placed responsibility ‘for developing legal infrastructure for the financial derivatives market’ upon financial and governmental authorities (Gadzhiev 2002). Amid the boom and expansion of global financial markets, the banking industry had also been pressing for legal changes. For instance, at the international industry conference in London in 2006 most of discussions revolved around the lack of legal provisions on cash-settlement being an obstacle for the growth of derivative trade between global and Russian banks, be it the Russian currency or lucrative oil contracts.

A year later, in January 2007, the market got what it asked for. Financial cash-settlement has been made enforceable in Russian law by amending Article 1062 of the Civil Code that states that gambling is not subject to judicial enforcement. The

exception was made for financial derivatives by adding a clause affirming that the rules of the article ‘shall not apply to claims related to participation in transactions envisioning the obligation of a party [...] to pay monetary amounts depending on variations in prices for goods, securities, rates of currency exchange, interest rate levels, the level of inflation, or on indices calculated on the basis of the aggregate of the foregoing indicators, or the occurrence of another circumstance which is envisioned by law and in relation to which it is not clear whether it will or will not occur’ (Davidovski & Runova 2007, p.36). The authors of the new clause admitted that the amendment ‘would not come out as [they] hoped for’:

Do not think I believe that derivatives are bets. I simply favour the most pragmatic and rational approach to making cash-settled derivatives enforceable (from an interview with a lawyer who is known as one of the authors of the amendment).

The ‘pragmatic and rational approach’ my interviewee refers to means two things that had to be taken into consideration while trying to build a legal framework for cash-settled derivatives. First, although the amendment contains only 200 words, this small legal technicality is a very complex matter: it involved politics shaped by a conflict of regulators, the Central Bank of Russia and the Federal Financial Markets Service.⁹ Second, and equally important, there was a third player in the field of financial law-making, the actor that defined the outcome of the regulatory conflict and legal battles – the Russian legal environment, the culture of civil law with its principal text, the Civil Code.

⁹ The Federal Financial Markets Service (FFMS) was established in 2004; its predecessor, the Federal Securities Market Commission (FSMC) had been involved in the regulatory controversy until the formation of FFMS.

The Law on Derivatives (2002-2004)

The financial derivatives market is a trade that involves banks as well as investment and asset management companies, i.e. banking and non-banking financial services.

The conventional division of regulatory labour is based on the assumption that systemic risk, and therefore the need to eliminate it, is crucial in regulating and monitoring banks, while consumer protection is a key concern for regulation of non-banking financial services (Goodhart et al. 1998). Consequently, the high danger of systemic risk, as exemplified by the most recent financial crises, determines the unique status of a chief banking regulator, a central bank.

The Central Bank of the Russian Federation, or the Bank of Russia, was granted its status and independence from the other state authorities in 1993. Being a centre of Russia's financial system, the bank, however, has no right to initiate legislation; the only way it can participate in law-making is by 'issuing its own regulations, but also owing to the fact that the drafts of federal laws and statutory acts of federal bodies of executive power concerning the performance by the Bank of Russia of its functions must be submitted to the Bank of Russia for consideration and approval' (BR 2012).

As part of the Russian economic reform, in the same year of 1993 the government established the Federal Securities Market Commission (FSMC) - a regulator responsible for non-banking financial services, for instance the security market and

stock exchanges.¹⁰ With the two authorities in place, the institutional settings for financial regulation were rather complicated, even more so with regards to cash-settled currency forwards. Traded over-the-counter, by banks, the contracts were under the jurisdiction of the Bank of Russia, making it a concerned party in terms of defining policies for the future development of the banking industry. Yet the Federal Securities Market Commission was a regulator in charge of financial markets in Russia, albeit without a power to oversee banks and audit. Both were considered regulators of the financial derivatives market, a market without a law to regulate the trade.

The question of making a law is tightly linked to the challenge of demarcating a regulatory domain (Brodsky 2001; Partnoy 2001). My interviewee, a lawyer whose current professional activity is concerned with the coordination and control of security market participants, admitted this was also the case in negotiations concerning the legal development on cash-settlement in Russia:

The legislative proposals were also used to redistribute the regulators' scope of authority in order to get relevant markets under their jurisdictions. Hence if

¹⁰ The Russian economic reform of 1993 is also known as the voucher privatisation. It served the aim of transferring ownership of enterprises from the state to its citizens, therefore the government issued and distributed privatisation vouchers, which were securities that denoted shareholdings in an enterprise. The Russians could either sell the vouchers, or retain their shares.

we were to give details, then naturally it had been a fight between the authorities.

To the Bank of Russia it was clear: a functional approach to regulation should be taken, where a regulator should focus on derivatives rather than on a type of financial services – banking or non-banking - that trades the contracts. The Federal Securities Market Commission insisted on regulating exchange-traded derivatives only, because ‘over-the counter instruments required no regulation but accounting and risk control, and under no circumstances a regulator should intervene’ (from an interview with an official that represented the FSMC at the time).

As a result, the Bank of Russia initiated the legal project that was promoting a full-scale law on derivatives (‘the Law’). Since OTC derivatives could not be regulated directly, the Bank was not keen on leaving exchange-based trade under the regulatory monopoly of the FSMC, therefore the Law aimed at promoting banks’ ability to trade all types of derivatives on exchanges, with no licence but complying with the Bank of Russia’s regulation.

They raised money to draft the Law thinking: ‘Guys, do you want to start up a derivatives market? Do we have a law on derivatives? No? Let’s make the law; let’s [...] copy everything from the American market’. So, very powerful banks and PricewaterhouseCoopers contracted to draft the law (from an interview with the financial law expert with one of the Russian legislators).¹¹

¹¹ My interviewee sounds rather sarcastic here because he did not support the idea of the Law, yet I introduced the quote to illustrate that the Law was seen as doing it

However, the working group faced a challenge to define what a derivative is, and this proved to be a difficult task. By seeing a derivative as ‘any contract based on probabilities’, they struggled with implementing this legally; the official from a Russian legislative authority, who is also known as the ‘driving force’ of the project, insists on the main advantage of the draft:

We did not use the word ‘betting’ whatsoever. Deliverable contracts clearly fell within the scope of a ‘standard contract’ term, thus under court protection, whereas OTC [cash-settled] derivatives were to be legitimised by Russian ISDA, an association of participants, under the responsibility of the association.¹²

Yet the draft failed to achieve its main goal - to define a derivative not in general terms, but ‘in civil law terms’ - therefore ‘there was a big problem with the text, from a legal point of view’ (interview with the financial lawyer who wrote several statutes for one of the Russian regulators), ‘it resulted in the draft that lawyers could not understand’, therefore could not classify (a lawyer in Russian banking association).

Amending the Civil Code (2004-2007)

‘American’, or ‘Anglo-Saxon’ way, in order to introduce the Bank of Russia’s position in the regulatory contest.

¹² ISDA is the International Swaps and Derivatives Association, a consortium of OTC derivatives market participants that joins forces of ‘815 members from 58 countries on six continents’ (ISDA 2012).

By the beginning of 2004 the working group abandoned its attempts to develop the draft and the legal negotiations came to a standstill. The pressure from the financial industry, however, grew: on August 10, 2005, the Federal Arbitration Court of Moscow District once again dismissed a claim over unsettled non-deliverable forwards between two Russian banks. Unlike all other court verdicts that declared the contracts unenforceable under Russian law, this overruling was particularly surprising – not just in its dismissal of a claim over such transactions, but in its dismissal of legal action (FAC 2005). From that moment such claims could not be taken to court.

A few months prior to this ruling the newly formed Federal Financial Markets Service (FFMS) had replaced the Federal Security Market Commission; the new regulatory authority had been established as a governmental body with the power to introduce legislation and make statutes (RF 2004). Oleg Vyugin, the Deputy Chairman of the Bank of Russia, had become Head of FFMS. He set his experts a task to redraft the Law on Derivatives by focusing on legal technicalities, therefore drafting the Law in the civil law terms. From the experts' point of view, there was a growing realisation that for the Russian legal system to be able to accommodate the law, it should be introduced or 'put through in bits and pieces: a bit in here, a piece in there' (from an interview with a FFMS legal expert).

The recognition of the importance of the existing legal environment resulted in the paradigm shift from the full-scale law on derivatives to a focus on changes in already existing laws, including the Civil Code. The suggestion to amend the Civil Code - Article 1062 in particular - seemed to appeal for two reasons. First, after all it was the Article that had been applied to cash-settled forwards by the Russian courts. Second,

the experts referred to Germany's experience of 1990-2005, the 'German way' of accommodating cash-settled derivatives legally:

When I'd learnt it in more detail, I had no doubts that our situation was the same, from a legal point of view. We had the same mentality, our market had internalised this financial innovation in the same way. There was an opinion that the most effective and developed American market is based in common law, so let's adapt, translate and plant the same into our legal soil. [...] I saw this as a sort of a German-American duel (from an interview with a financial law expert, a fierce proponent of the Amendment).

According to another expert and one of the Amendment's authors, 'the Russian judicial system does not deal with abstract terms', i.e. terms that do not correspond to the existing legal classification. However, my interviewee continues:

The definition of gambling is also ambiguous in the [Russian] Civil Code, so to a Russian lawyer it was not feasible to draw a line between an abstract notion of a derivative and the ambiguity of a bet. The abstract definition of a derivative let Russian courts classify cash-settled forwards as gambling. We suggested not arguing with the Supreme Arbitration Court over the matter, but to claim that certain derivatives were court-protected. It therefore led to the amendment of 1062 Article of the Civil Code.

The text of the amendment had been written and sent for approval by the Centre for Private Law and the Council for the Codification and Improvement of the Civil Legislation. These authorities provide expertise on legal text by examining whether drafts are consistent with the main principles of Russian law. The authors of the Russian Civil Code and the Chairman of the Supreme Arbitration Court were among

the experts and their verdict did not prove to be a straightforward matter - the negotiations of the clause lasted for almost a year. Providing a legal expert opinion certainly is never a task performed quickly. In fact, ‘making changes to the Civil Code is one of the most difficult undertakings with regard to their approval, it is considered to be special legal achievement – “I have managed to alter the Civil Code!”’(an official from the Russian Ministry of Finance). Being a matter of compliance with the legal narrative engendered by the Code, it demands exhaustive treatment of the financial contract in relation to the general principals of Russian law, hence a lengthy commentary produced for the codifiers that eventually helped the negotiations. In June 2006 the State Duma of the Federal Assembly of the Russian Federation approved the bill ‘On Amending Article 1062 of the Part Two of the Civil Code of the Russian Federation’. An approval from the upper chamber of the Federal Assembly, the Federation Council, came in January 2007, followed by the President’s signing that confirmed the change in the Civil Code. Remarkably, cash-settled financial derivatives have remained bets, yet with an exceptional legal status – they are bets that are enforceable in Russian law.

Discussion and Conclusion

The given account of the legal development regarding cash-settled derivatives is a result of fieldwork that aimed at exploring financial law-making, thus supplementing the research that is highly topical yet regrettably scarce. This article has shown how, despite all the efforts made to legitimise financial derivatives, to make the distinction between gambling and finance permanent and unequivocal, the fact that the gambling status ‘continues to haunt modern credit practices’ (Goede 2005, p.84) was confirmed

yet again when the same issue reappeared in Russia in 1998.¹³ Moreover, in their attempts to make financial derivatives enforceable under Russian law, the lawyers could not find other way but define them as a particular instance of a bet, as ‘de jure the concepts [of a bet and cash-settled forward] are the same’ (in the words of one of the amendment’s authors). Although such definition weakens the fundamental hostility of Russian law to gambling, it does not, however, stabilise the still fragile separation between gambling and financial derivatives, as the most recent financial crisis taught us by showing that the indelible line between gambling and finance has yet to be drawn. Indeed, as Goede (2005, p.84) rightly argues, the distinction between the two ‘hinges on perception of morality, character, and excess’.

It is worth also considering another important link between the Russian events of 1998 and the recent financial turmoil. What happened in Russia in 1998 was not simply a matter of an emerging market economy being inevitably prone to financial predicaments; the case substantiates one of the precepts for the social studies of finance research - ‘scales aren’t stable’ (MacKenzie 2009, p.33). The global banks’ losses from cash-settled forwards (outlawed by Russian courts through the reference to gambling) provoked the so called ‘flight to quality’ in the markets: to cover the losses global banks and hedge funds started selling assets and the followed price movements were magnified by ‘imitators’ in highly globalised financial markets, which, in turn, triggered the global demand in financial assets that were secure; the

¹³ Few of my interviewees have acknowledged that the main reason for classifying cash-settled derivatives as bets was a political expedient. However, the very fact that the political measure was performed by employing gambling law confirms the still-strong link between the two – non-deliverable derivatives trading and betting.

hedge fund Long-Term Capital Management suffered most and, with an assistance of the Federal Reserve, it was re-capitalised in September 1998, followed by the cut in interest rates in October 1998 (MacKenzie 2006). Low interest rates restored financial confidence, but this confidence produced what is now called ‘bubbles’ - the Dotcom and US housing bubble. The burst of the housing bubble triggered the global financial crisis of 2008, thus scaling up the initial losses from cash-settled forwards and supporting the SSF assumption of “‘technicalities’ that matter’ (MacKenzie 2009, p.33).

The ‘cultural geography’ perspective (MacKenzie 2009, p.73) on derivatives is another SSF issue that is addressed in this article by its focus on ‘local legal culture’. It represents another way of investigating modern finance through its ‘cultural economy’ (Pryke & Gay 2007): by analysing the impact of local legal culture in financial law-making it is possible to render location to global financial derivatives trade, to see the ‘material production’ (MacKenzie 2009) of it in action. Regarded as highly virtual, cash-settled derivatives are, in fact, an outcome of a material making, where ‘material’ also means legal technicalities of their production. As it has been shown, local legal cultures vastly affect financial markets, for example by differentiating between sound financial activities and gambling, and such differentiation has not yet proved to be a settled legal matter.

The case study, furthermore, has allowed raising another analytical issue: local legal culture that is not reducible to politics. While listening to the accounts of financial lawyers and regulators (which were exciting and often emotional oral histories one could listen to for many hours!), I became aware of the fact that there are many stories

to tell, and all the stories are cogent in their acknowledgement of politics being the important driving force of, as well as the context for, the legal battles. However, what I also discovered is that, although not so conspicuous, there was also another component that, in some way or another, was always referred to. The local legal culture proved to be a significant actor, given that an actor is '*any thing* that does modify a state of affairs by making a difference' (Latour 2005, p.71, emphasis in original).

Take, for example, a civil law tradition with the Civil Code as the very core of it. The latter is a system of written rules, it is a tangible form to, or an embodiment of, the existing legal traditions and practices; it is a compendium that provides the local legal ethos with a physical form. As Russian legal system is a system of codified law, it is based on the idea of consistency; 'it is important that the law be presented in statutory form as a coherent whole' (Burnham et al. 2004, p.2). Such coherency cannot be maintained without uniformity of legal terms used throughout a body of law - in already existing and new statutes. The legal experts that guard the systematic character of Russian law were not able to adopt the abstract terms that described derivatives in the Law promoted by the Bank of Russia. These terms did not exist in the legal organism called Russian law and the Civil Code that manifests it. The Civil Code – the text - emerged as a third party in the 'turf war' between the two Russian regulators and as an actor that tipped the balance. It demonstrated that, however powerful legal actors are, the success of their lobbying depends, among other factors, on how their legal initiatives can be accommodated by the legal principles and techniques that are already in place, codified and safeguarded. The politics of financial law-making is always a process that is based on a clash of interests, but

those pursuing their interests know all too well that in order to succeed in the tug-of-war one's interests should be adoptable by the systematic collection of legal texts adhered to and employed by the legal community.

The civil law tradition does epitomise the notion of culture by emphasising the importance of action distributed by various types of agencies including material objects, e.g. in a form of texts. However, despite the nature of civil law that, unlike common law, is made of codified general principles rather than open-ended interpretations of legal precedents, there is evidence to suggest that the civil law tradition also accommodates a type of reasoning that does not merely comply with the general principles, but propels and develops the foundations of law. Let me return to the my interviewee's compelling argument reflecting on the decision to amend the Civil Code article that deals with gambling, therefore to regulate cash-settled derivatives by the same statute. The author of the Amendment reasons that, to be able to make cash-settled derivatives legally enforceable, in their search they have found no other way but to classify them as bets (admitting their similarity as both based on probability). As my interviewee argued, when asked why financial derivatives were defined as a different kind of bets, 'try to find a law that describes them in precise terms. They are defined abstractly. Or they are simply listed. In many jurisdictions. Yet when we make the law we must say, for instance, "a forward is this and this", we have to define it through existing legal terms. [...] The Civil Code itself dictated its terms and its legal technique, so it was not possible to write more or differently'. To employ finitist terminology (Barnes et al. 1996), the lawyers had to classify cash-settled derivatives, therefore the *analogy* between these financial instruments and gambling was *extended* as dictated by the text (the Civil Code), making this way the

only way to grant legal protection to the financial contracts. However, this extended analogy is a new form of knowledge produced by similarities between the financial derivatives and bets. Through interpreting a text that, as my interviewee put it, ‘defines a bet rather vaguely’, the lawyers introduce a particular case that performs the opposite – it grants legal protection. Not only this form is based on correspondence between the two, it possesses a new quality of bets – court-protected instances of bets – therefore undermines the hostile attitude of Russian law towards gambling. Indeed, as finitism argues, ‘future use of our conventions of classification is undetermined and indeterminate’ (Barnes et al. 1996, p.54).

So far a claim was made that legal culture is an array of interpretative acts originated in certain conventions but not determined by them; culture is not what engenders action, but rather what ‘orients us to experience in its own way’ (Barnes et al. 1996, p.54). However, it has been also argued that, as well as action, legal culture (as instantiated by the Civil Code) is an actor in the sense that it is an element of what actor-network theory calls *agencements* when arguing that actions are not carried out in ‘an object-less social world’ (Callon 2005; Latour 2005, pp.82,84). By rejecting either approach in defining legal culture one would risk impoverishing the very notion of it, stripping the legal culture of its essential power to enhance our understanding of how financial law is made.

It is tempting to think that the design of the Russian legal infrastructure for financial derivatives could have been developed one way or another, depending on weight, prominence or determination of the parties whose interests are at stake. While in Moscow, I learned about the ‘turf war’ – politics is immediately apparent once one

starts enquiring into how a law is drawn up. What if the Bank of Russia persevered in its attempts to write the Law on Derivatives by, for instance, hiring more experts, or being more strategic in the conflict with both the Federal Securities Market Commission and the Federal Financial Markets Service over their regulatory domains? I found myself in a situation where, sympathising with the advocates of the Law, I thought of the Civil Code's amendment as an unfortunate development - so irresistible was the enthusiasm of those advocating the full-scale law on derivatives.

In time, however, it became clear that the local legal culture could not be ignored: it kept appearing in all the accounts. As I conducted more interviews, listened to more and more stories, constant references to the legal conventions, firmly held beliefs and opinions, the text of the Civil Code, have become evident. To discount them would be to deny the intricacy and the principled nature of legal reasoning, thus reducing law to politics, pure and simple, and in so doing refusing law its real authority - its power to constitute 'society' despite ever-changing politics.

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Appendix

Interviewing has been chosen as a main method for collecting data because the substantial part of the debates on legal enforceability of cash-settled derivatives was not publicly available; moreover, the scarce market data could not provide for an adequate picture of the market and in-depth interviews with market participants were invaluable sources of information. 19 officials from regulatory bodies and legal experts and 16 market participants were interviewed in London and Moscow in the period of 9 months – between February and October of 2007. Three groups can be discerned among the interviewed. First, the market participants based in London, mainly brokers in big brokerage firms known to be most active on the US dollar/Russian rouble (USD/RUB) cash-settled forward market. Second, traders and analysts in Moscow banks and also officials from the two major Russian stock-exchanges (the Moscow Interbank Currency Exchange and the Russian Trading System, merged in 2011). The third group of interviewees comprised those involved in the legal debates on how to make cash-settled derivatives court-protected under Russian law, namely legal experts in the Bank of Russia, the Federal Financial Markets Service, the Ministry of Finance, experts in Russian parliamentary committees, financial lawyers representing Russian and foreign banks (in-house lawyers) and lawyers in Moscow branches of global law firms. The interviews lasted between one and four hours, they were recorded and transcribed, quotes from interviews conducted in Russian were translated into English by the author.

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